

Message Text

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C O N F I D E N T I A L COLOMBO 2978

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TAGS:

SUBJ: FINANCE MINISTER BANDARAKAIKE'S STRATEGY

REF: COLOMBO 2913

1. SUMMARY: FINANCE MINISTER FELIX DIAS BANDARANAIKE HAS GIVEN ME, IN CONFIDENCE, AN OUTLINE OF HIS ECONOMIC STRATEGY WHICH INVOLVES FAR-REACHING CURRENCY REFORMS, INCLUDING DECISION TO FLOAT THE RUPEE. OBJECTIVE WILL BE TO CURB INFLATION, STIMULATE EMPLOYMENT, AND ENHANCE ECONOMIC DEVELOPMENT AND GROWTH. DEVELOPMENT SAVINGS BANKS WILL BE AN IMPORTANT INSTRUMENT IN THE ACHIEVEMENT OF THESE OBJECTIVES. HE HOPES THAT HIS PACKAGE OF PROPOSALS WILL BE SALABLE TO THE IMF IN LIEU OF DEVALUATION AND THAT THE IMF WILL COME THROUGH WITH SOME \$115 MILLION IN FOREIGN EXCHANGE ASSISTANCE. HOWEVER, HE FACES A MAJOR SHORT-TERM FOREIGN EXCHANGE GAP OF SOME \$50 MILLION AND HOPES USG WILL HELP PROVIDE SUPPORT. I TOLD BANDARANAIKE THAT HIS PROPOSAL SEEMED INGENIOUS BUT WOULD REQUIRE FURTHER DETAILS AND STUDY. WE COULD NOT PROVIDE SHORT-TERM FINANCIAL ASSISTANCE BUT WE MIGHT BE ABLE TO INDICATE TO US COMMERCIAL BANKS AND IMF THAT WE REGARDED HIS STRATEGY AS SOUND AND DESERVING OF SUPPORT. END SUMMARY.

2. AT PRIVATE LUNCH SEPT 16, SRI LANKA'S NEW
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FINANCE MINISTER FELIX DIAS BANDARANAIKE OUTLINED

IN CONFIDENCE TO ME HIS ECONOMIC STRATEGY FOR NEXT SIX MONTHS. HE DID SO IN CONTEXT OF FAVORABLE COMMENTS ON SECRETARY KISSINGER'S UN SPECIAL SESSION SPEECH, NOTING THAT THIS SPEECH AND US POSTURE VIS-A-VIS DEVELOPING COUNTRIES PROVIDE BASIS FOR MORE COOPERATIVE ECONOMIC RELATIONSHIP BETWEEN UNITED STATES AND SRI LANKA.

3. BANDARANAIKE ALSO UNDERScored HIS REALIZATION THAT HE WAS OPERATING WITHIN NARROW POLITICAL PARAMETERS. PRIME MINISTER BANDARANAIKE HAD OFFERED HIM FINANCE PORTFOLIO AFTER T.B. ILANGARATNE HAD TURNED IT DOWN AND HE RECOGNIZED THAT HE HAD ONLY SOME 18 MONTHS TO PRODUCE RESULTS BEFORE NEXT GENERAL ELECTIONS IN 1977. RECRIMINATIONS REGARDING PAST MANAGEMENT OF THE ECONOMY SERVED LITTLE PURPOSE BUT FACT REMAINED THAT SRI LANKA'S ECONOMIC SITUATION WAS CRITICAL. COUNTRY HAD SHOWN LITTLE GROWTH OR DEVELOPMENT DURING PAST FIVE YEARS.

4. FINANCE MINISTER NOTED THUQ HIS STRATEGY HAD TO BE WORKED OUT IN CONTEXT OF CONTINUED PRESSURE BY IMF FOR GSL TO DEVALUE IN RETURN FOR STANDBY AND OIL FACILITY ASSISTANCE. HE HAD STUDIED IMF'S PACKAGE PROPOSALS AND WAS AWARE THAT FORMER FINANCE MINISTER PERERA HAD PRIVATELY INDICATED HE WOULD BE WILLING TO DEVALUTE IF COMPANY ESTATES WERE NATIONALIZED. HOWEVER, IT WAS ALREADY CLEAR THAT PERERA, NOW IN OPPOSITION, WOULD ATTACK MRS BANDARANAIKE'S GOVERNMENT IF GSL DEVALUTED. ACCORDINGLY, HIS TASK WOULD BE TO DEVISE A STRATGY WHICH WOULD ACHIEVE BETTER RESULTS THAN DEVALUATION AND WHICH WOULD SATISFY INTERNATIONAL LENDING AGENCIES WHILE AVOIDING ADVERSE DOMESTIC POLTICIAL REPERCUSSIONS.

5. EXPLAINING HIS IDEAS WERE NOT ORIGINAL BUT WERE BASED ON STUDY OF POLICIES OFNUMBER OF OTHER COUNT-TRIES, BANDARANAIKE SAID HIS STRATEGY WAS DESIGNED TO ACHIEVE SEVERAL OBJECTIVES: CONTAIN INFLATION, CREATE EMPLOYMENT AND STIMULATE ECONOMIC DEVELOPMENT AND CONFIDENTIAL

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GROWTH. HE PLANNED TO CONCENTRATE ON CURRENCY REFORM WITH FOLLOWING AS LIKELY FIRST STEPS:

A) CONVERT THE PRESENT SRI LANKA RUPEE INTO A NEW SRI LANKA DOLLAR OR A CURRENCY UNDER ANOTHER APPROPRIATE NAME. EXACT RATIO WOULD HAVE TO BE WORKED OUT BUT, FOR ILLUSTRATIVE PURPOSES, THE NEW CEYLONese DOLLAR MIGHT BE ISSUED ON THE BASIS OF ONE DOLLAR

FOR RS 10 OF EXISTING CURRENCY.

B) TO CURB INFLATION, THE HOLDERS OF THE NEW CURRENCY WOULD BE REQUIRED TO DEPOSIT ONE-TENTH OF THEIR HOLDINGS IN DEVELOPMENT SAVINGS BANKS TO BE USED FOR SPECIFIED PURPOSES.

C) TO STIMULATE THE ECONOMY, APPROX THE SAME AMOUNT OF NEW MONEY (I.E., ABOUT ONE-TENTH OF THE MONEY SUPPLY) WOULD BE PRINTED AND PUT INTO CIRCULATION.

6. ONCE THESE INITIAL STEPS HAD BEEN IMPLEMENTED, BANDARANAIKE SAID THE NEXT IMPORTANT ACTION WOULD BE TO FLOAT THE RUPEE. THIS COULD BE DONE SOMETIME EARLY IN 1976. SUCH ACTION, IN HIS JUDGMENT, WOULD PROVIDE MAJOR STIMULATION TO ALL OF THE ECONOMY. IT WOULD SPUR AGRICULTURAL PRODUCTION AND GIVE A MAJOR LIFT TO THE DPRIVATE SECTOR. WITH RUPEE FLOATED, DOMESTIC PRICES WOULD BE SUBJECT TO INTERNATIONAL PRICE TRENDS. FURTHERMORE, GOVT WOULD BE ABLE TO DISASSEMBLE LARGE PART OF BUREAUCRATIC STRUCTURE NOW REQUIRED TO HANDLE THE COUNTRY'S COMPLEX IMPORT-EXPORT REGULATIONS.

7. BANDARANAIKE SAID THAT THE TIMING OF HIS PROPOSALS WAS CRITICALLY IMPORTANT IN TERMS OF THEIR POLITICAL SALABILITY. THE CURRENCY REFORM PACKAGE MIGHT BE PUT FORWARD IN GENERAL TERMS AT THE TIME OF THE NEXT BUDGET (NOV 5) ALTHOUGH NO FINAL DECISION HAD BEEN REACHED. IN THE CONTEXT OF THE BUDGET, IT WAS ALSO POLTITICALLY CONFIDENTIAL

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NECESSARY TO PROVIDE SOME FORM OF RELIEF TO THE GENERAL POPULATION WHICH WAS LOOKING TO HIM AS THE NEW FINANCE MINISTER TO DO BETTER THAN HIS PREDECESSOR. HE WAS CONSIDERING A NUMBER OF MEASURES TO PROVIDE EITHR TAX RELIEF OR RELIEF FROM IMPORT DUTIES, BUT, AGAIN NO FCHAL BICSION HAD BEEN MADE. SPECIFICALLY, HE WAS THINKING OF LIFTING DUTIES ON IMPORTED AGRICULTURAL IN-PUTS, SUCH AS TRACTORS AND OTHER EQUIPMENT, WHICH PROVIDED ONLY ABOUT RS 50 MILLION IN REVENUE BUT APPRECIABLY ENHANCED IN-PUT COSTS TO FARMERS.

8. THE FINANCE MINISTER SAID THAT HE HAD NOT REVEALED THE TERMS OF HIS PLANS TO IMF

WHILE IN WASHINGTON,BUT HAD ASKED THE IMF TO SEND A TEAM BACK TO SRI LANKA IN EARLY OCT FOR FURTHER DISCUSSIONS REGARDING ASSISTANCE UNDER THE STANDBY AND OIL FACILITY. HE PLANNED TO DISCUSS HIS GENERAL PLANS WITH THE IMF TEAM AT THAT TIME WITH THE HOPE THAT THE PROPOSALS WOULD PROVE ATTRACTIVE ENOUGH TO THE IMF SO THAT THEY WOULD BE WILLING TO PROCEED WITH BOTH TYPES OF HELP, WHICH HE ESTIMAED WOULD TOTAL ABOUT \$115 MILLION ((FYI: A HIGHER FIGURE THAN WE HAD BEEN GIVEN EARLIER END FYI).

9. ALTHOUGH HOPEFULLY IMF WOULD LOOK FAVORABLY ON HIS PROPOSED NEW STRATEGY, THE COUNTRY, NONETHELESS, FACED A CRITICAL SHORT-TERM LIQUIDITY PROBLEM. SOME ESTIMATES OF ZVTAL FOREIGN EXCHANGE SHORTFALL RANGED AS HIGH AS RS ONE THOUSAND ONE HUNDRED MILLION. HE PERSONALLY BELIEVED SOME OF CENTRAL BANK'S ESTIMATES WERE INACCURATE AND THAT AMOUNT OF MONEY NEEDED TO PAY BILLS IN OCTOBER WAS SOMEWHERE IN NEIGHBORHOOLD OF RS 300,000,000 OR ABOUT US \$50 MILLION. HE SPECIFICALLY WANTED TO KNOW WHETHER USG COULD HELP SRI LANKA COVER THIS SHORT-TERM REQUIREMENT. CONFIDENTIAL

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10. I TOLD BANDARANAIKE THAT I THOUGH HIS STRATEGY WAS INGENIOUS BOTH IN ITS POLITICAL CONCEPTION AND ECONOMIC OBJECTIVES, BUT WITHOUT FURTHER STUDY EHD DETAILS I WAS MYSELF NOT COMPETENT TO JUDGE ITS EFFICACY. BECAUSE OF OUR CONGRESSIONAL RESTRAINTS WE COULD NOT PROVIDE SHORT-TERM BUDGET SUPPORT ASSISTANCE EXCEPT TO COUNTRIES WHICH WERE LEGISLATIVELY- DESIGNATED AS COUNTRIES WITH WHICH WE HAD SPECIAL SECURITY ARRANGEMENTS. HE ACCEPTED THIS EXPLANATION BUT ASKED WHETHER WE COULD BE HELPFUL WITH US COMMERCIAL BANCY, MENTIONING SPECIFICALLY MANUFACTURERS HANOVER AND CHASE MANHATTAN. HE ALSO ASKED IF WE COULD INDICATE TO THE WORLD BANK AND THE IMF THAT HIS NEW ECONOMIC STRATEGY APPEARED WELL CONCEIVED AND DESERVING OF THEIR SUPPORT.

11. I REPLIED THAT EVEN IF WE CONCLUDED THAT HIS PLAN WAS A SOUND ONE, I DID NOT BELIEVE WE COULD DIRECTLY

APPROACH AMERICAN COMMERCIAL BANKS. HOWEVER,
WE PROBABLY WOULD BE ABLE ON AN "IF ASKED"
BASIS TO ADVISE BANKS THAT GENERAL THRUST OF
GSL PROPOSALS SEEMED SOUND AND WORTHY OF SUPPORT.
(FYI: ALTHOUGH I DID NOT MENTION THE CIRCUM-
STANCES TO BANDARANAIKE, I HAD IN MIND SIMILAR
ASSURANCES WHICH DEPT HAD AUTHORIZED ME
TO CONVEY TO SECRETARY OF PLANNING AND
ECONOMIC AFFAIRS GUNASEKERA IN APRIL 1974
(STATE 85385; COLOMBO 1166) END FYI.) I WENT
ON TO TELL HIM THAT I THOUGH WE COULD CONVEY
SIMILAR FAVORABLE COMMENTS TO THE IMF BUT I
WOULD FIRST WANT TO HAVE SOME MORE DETAILS
BEFORE I COULD MAKE A RECOMMENDATION TO
WASHINGTON. BANDARANAIKE SAID THIS WAS A FAIR
ENOUGH PROPOSITION AND AGREED TO KEEP ME CLOSELY
POSTED AS HIS PLAN DEVELOPS.
VAN HOLLEN

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